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SUBJECT: IMPACT OF RISING FOOD/COMMODITY PRICES - RUSSIA

REF: A. STATE 39410
 [1](#)B. GAIN REPORT RS8031
 [1](#)C. MOSCOW 366
 [1](#)D. (07) MOSCOW 5373
 [1](#)E. (07) MOSCOW 5200
 [1](#)F. (07) MOSCOW 5133

Summary

[1](#)1. 1. (SBU) In Russia, basic commodity prices for products have spiraled in recent months, with price increases registered of up to 70 percent nationwide for vegetable oils, and 50 to 100 percent for potatoes in some regions in Russia. The poorest in Russia, who spend nearly two-thirds of their monthly incomes on food, have been hardest hit. However, only one known protest has been held, in Vladivostok. The government has restricted grain and fertilizer exports as well as imposed price freezes--due to expire on May 1--on "socially significant" foodstuffs. Russia's market-distorting prescriptions have been inadequate, however, failing to rein in inflation and to increase production sufficiently to address domestic and export demands. End Summary.

Food and Agricultural Commodity Demand

[1](#)2. (SBU) The agricultural commodities that constitute the bulk of Russia's food demand are beef and pork, poultry, eggs, milk and dairy, vegetable oils, grains and sugar, and vegetables. The pass-through effect that world prices have had on these items domestically in the last year has varied significantly. For instance, granulated sugar prices rose 6.4 percent on average nationwide from mid-March 2007 to mid-March 2008, but bulk domestic sunflower oil climbed more than 70 percent in the same period. The variation in prices among regions was also pronounced, owing to differences in preferences as well as costs associated with inputs such as transportation. The price for a kilogram of potatoes in Primorskiy Kray (the southern area of Russia's Pacific coast) increased 10.3 percent during the year between March 2007 and March 2008, whereas in Sverdlovsk Oblast' (just east of the Urals) the price rose 98.9 percent.

[1](#)3. (SBU) Spending on food consumes approximately 50 percent of a household's income. The poorest 10 percent of Russia's population spent RUB 1,045 per month per capita, almost USD

43 or 70 percent of monthly income, on food during 2007. The wealthiest 10 percent, however, spent RUB 9,806 per month, nearly USD 400 or 26 percent of monthly income. The regressive nature of food price increases are particularly acute for the urban poor who lack access to household garden plots. Government officials' recognition of this circumstance informed their decision in late 2007 to formulate an agreement with food processors and retailers to freeze prices for "socially significant" products.

Supply

14. (SBU) Grain and oilseed producers increased their supply in response to rising world prices. The area planted last fall marked a reversal of the steady decline that had begun in the 1970s. According to the sowing intentions declared by many producers, the grain and oilseed area for 2008 should be 10 percent greater than for 2007. Higher dairy prices have, likewise, raised interest in boosting herd averages (average milk yield per cow) by importing improved foreign dairy genetics. Rising grain prices, however, have in turn raised production costs and, thereby, served as a brake on the growth of beef, dairy, and pork output. High input prices in combination with underdeveloped marketing infrastructure have depressed the prices paid to many producers below the break-even point.

15. (SBU) Russia's grain crop for 2007 was high enough to allow the country to emerge as the third-largest wheat exporter for the year. Russia's agricultural production overall, however, has not kept pace with the country's pace of demand. Incomes have grown 7 to 10 percent annually since 1998, but production has grown by only 1 to 3 percent annually during the same period. As a result, imports have risen each year, from USD 11 billion in 2003 to USD 27.5 billion in 2007.

Domestic Politics

16. (SBU) In fall 2007, the perceived "food effect" on Russia's inflation prompted senior government officials to adopt "stabilization" measures to hinder the growth of rising prices. The concern among some Cabinet officials appeared to be that the inflation spike just before the Duma (parliament) elections in December 2007 would discourage voters from providing a constitutional majority to the United Russia Party, whose ticket President Putin had agreed to lead. Consequently, Prime Minister Zubkov and Agriculture Minister Gordeyev, according to media reports, began pressuring food processors and retailers to absorb rising food costs so consumers would face stable prices in the run-up to the elections. The Ministry of Agriculture also acted to increase domestic supplies of grains and fertilizer by raising export duties and drafted a voluntary agreement with retailers to freeze prices on "socially significant" items through the spring of 2008.

17. (SBU) Memories of the 2005 protests against the monetization of benefits also probably informed the decision to pursue these measures. The monetization effort sought to supply certain groups, such as pensioners, with budget funds in lieu of free services, such as public transportation, which the groups had received as an entitlement. To date, only one known organized protest against rising food prices has been held, in Vladivostok on April 26, 2008.

Economy

18. (SBU) Russia's commodity-heavy economy has grown as world prices of many commodities, particularly oil, have risen to record levels. The rising tide of Russia's petrochemical industry has lifted many boats, from government revenues, to

transportation, construction, and steel to banking, hotels, and telecommunications. As a result of this growth, government spending and wages have risen steadily during the last ten years. Experts cite these monetary factors as key causes behind Russia's 11.9 percent inflation for 2007, but acknowledge that higher food prices helped push inflation higher. Wages, for instance, have risen faster than productivity in recent years. The bulk of these so-called "salary overhangs" have gone directly into the economy in the form of consumer spending. Increased government spending, on public sector salaries and on the formation of state corporations, has also driven prices up. Fiscal expenditures equalled 20.3 percent of GDP in 2007, nearly 4 percent of GDP higher than in 2006.

¶9. (SBU) Underinvestment has also exacerbated inflation. The pace of salary increases have meant that domestic producers of all goods, including food, have not been able to keep pace with the demand for higher quality products. Producers have made some investments to expand capacity, but imports of consumer goods have filled the gap and have exacerbated inflation. As it stands, however, imports into Russia and their prices are growing. Domestic demand for food has more than doubled in real terms since 2000, according to many estimates, but domestic production has increased only 20 percent. Russia imports an estimated 40 percent of its food supply.

GOR Policies

¶10. (SBU) The GOR's policy response to date has been a series of attempts at "stabilization" measures to slow inflation and shore up the domestic supply of food. Increased export duties on wheat, barley and mineral fertilizers as well as releases of reserve grain stocks to selected millers have been among the government's efforts to insulate domestic prices from the influence of global trends. Although the higher duties are set to expire on June 30, the duties could remain above their pre-intervention level. Ministry of Agriculture officials are considering instituting a program that would use grain export revenues to provide compensation for domestic poultry producers' feed expenses.

¶11. (SBU) In October 2007, Ministry of Agriculture officials implemented a voluntary agreement with producers, processors and retail supermarkets to absorb rising food costs as a means of ensuring consumers would face stable prices on "socially significant" foodstuffs. In an effort to extend and amplify the scope of this agreement, the Ministry of Economic Development and Trade has drafted legislation for Cabinet consideration that would cap retail price margins on many of these same "significant" products. The Ministry of Agriculture has also developed a program of minimum threshold prices as an incentive for domestic producers to ensure that the current food supply will not suffer shortages and, thus, foist higher prices onto consumers.

Comment

¶12. (SBU) The lifting of price controls is expected to trigger even higher inflation, now at 14 percent for the past 12 months. Russia's government has few tools at its disposal to rein in inflation, further ruble appreciation will hurt exporters. As long as worldwide commodity prices stay high, Russian inflation will remain double-digit, with Russia's most vulnerable populations suffering the most.
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